

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name Chain of Lakes Area Utilities Authority	County Newaygo
Audit Date 3/31/06	Opinion Date 6/14/06	Date Accountant Report Submitted to State: 8/14/06	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- | | |
|---|---|
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) Brickley DeLong, PLC			
Street Address 500 Terrace Plaza, P.O. Box 999		City Muskegon	State MI
		ZIP 49443-0999	Date 8/14/06

Accountant Signature: *Trinity D. Carter, C.P.A. for Brickley DeLong, PLC*

Chain of Lakes Area Utilities Authority
Newaygo County, Michigan

REPORT ON FINANCIAL STATEMENTS
(with required supplementary information)

Year ended March 31, 2006

Chain of Lakes Area Utilities Authority

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This section of the Chain of Lakes Area Utilities Authority (Authority) annual financial report presents our discussion and analysis of the Authority's financial performance during the year ended March 31, 2006. Please read it in conjunction with the Authority's financial statements, which immediately follow this section.

Using this Annual Report

This annual report consists of a series of financial statements and notes to those statements. These statements are organized so the reader can understand the Chain of Lakes Area Utilities Authority financially as a whole. The basic financial statements are comprised of the following elements:

Management's Discussion and Analysis (MD&A)

(Required Supplemental Information)

Basic Financial Statements

Financial Statements

Statement of Net Assets

Statement of Revenues, Expenses and Changes in Activities

Statement of Cash Flows

Notes to Basic Financial Statements

The Statement of Net Assets provides balances as of the end of the reporting period. The Statement of Revenues, Expenses, and Changes in Net Assets provides information related to the activities of the Authority during the year. The statement of cash flows presents detailed information about the Authority's cash collections and disbursements during the year. The notes to the financial statements provides the reader specific information related to accounting policies and certain balances in the financial statements.

Financial Overview

Recall that the statement of net assets provides the perspective of the Authority as a whole.

Net Assets

	2006	2005
Current assets and other assets	\$ 4,871,338	\$ 5,353,190
Capital assets	7,811,258	7,582,230
Total assets	12,682,596	12,935,420
Current liabilities	948,007	578,368
Noncurrent liabilities	6,309,320	6,731,904
Total liabilities	7,257,327	7,310,272
Net assets (deficit)		
Invested in capital assets, net of related debt	1,098,871	829,857
Restricted	4,215,543	4,826,847
Unrestricted	110,855	(31,556)
Total net assets	\$ 5,425,269	\$ 5,625,148

The above table focuses on assets, liabilities and net assets. The Authority's current assets and other assets decreased due to normal repayment of long-term debt. This decrease was partially offset by a litigation settlement of \$500,000 awarded at the end of the year. Capital assets represents land, easements, infrastructure and the actual plant. Capital assets increased due to the final construction costs related to completion of the system. Current liabilities increased as the costs related to the litigation settlement discussed above. These costs are shown in accounts payable at March 31, 2006 and account for half of the overall increase in current liabilities.

Net assets represents the difference between the Authority's assets and liabilities. Net assets are split into three components. Invested in capital assets, net of related debt represents the cost of the capital assets net of accumulated depreciation less outstanding long-term debt incurred in constructing the plant. Invested in capital assets increased due to the final construction costs to complete the system as well as normal repayment of debt during the year. Since capital assets represent physical assets, they are not available to pay current expenditures. Restricted net assets represents resources restricted for repayment of long-term debt. Restricted net assets decreased during the year due to repayment of debt. The remaining portion of net assets is unrestricted, and it is available to pay future costs.

In comparing this year's statement of net assets to last year, there are very significant differences. Fiscal year ending March 31, 2006 is the first year of significant system operation. The prior year had minimal billings and the majority of expenses incurred related to the construction of the plant which were capitalized as capital assets.

The results of this year's operations for the Authority are reported in the statement of activities, which shows the changes in net assets for fiscal year 2006.

Changes in Net Assets		
	<u>2006</u>	<u>2005</u>
Revenues		
Charges for services	\$ 221,822	\$ 25,368
Expenses		
Administration	10,966	6,864
Operations	297,968	-
Depreciation	154,311	-
Total expenses	<u>463,245</u>	<u>6,864</u>
Operating income (loss)	(241,423)	18,504

	<u>2006</u>	<u>2005</u>
Nonoperating revenues (expenses)		
Investment income	\$ 213,724	\$ 209,931
Interest expense	(262,083)	-
Total nonoperating revenues (expenses)	<u>(48,359)</u>	<u>209,931</u>
Income (loss) before special item	(289,782)	228,435
Litigation settlement - net	<u>89,903</u>	<u>-</u>
Change in net assets	(199,879)	228,435
Net assets - Beginning, restated	<u>5,625,148</u>	<u>5,396,713</u>
Net assets - Ending	<u>\$ 5,425,269</u>	<u>\$ 5,625,148</u>

The above analysis of the statement of activities highlights changes in the statement of activities. During the year, the Authority had a significant increase in charges for services as the sewer system became fully operational. Residences were hooked up to the sewer system throughout the year. Thus as the year progressed the amount of revenues billed each quarter increased with each billing. In addition, as of July 2005, all residences of the Authority were required to pay and were billed for services even if not yet connected to the system. The contracted services amount represents the costs paid to an outside service for managing the system. The depreciation represents the cost of the system depreciated over the estimated useful life. The litigation settlement, net represents the gross settlement amount less professional fees incurred in a lawsuit in relation to the design and construction of the system. The investment income represents primarily the interest income on the special assessments. Interest expense represents normal interest costs associated with outstanding long-term debt.

Capital Asset and Debt

Capital Assets

At March 31, 2006, the Authority had \$7,811,258 (after accumulated depreciation) invested in the Authority's sewer system. This amount represents a net increase (including additions, deductions, and depreciation) of \$229,028 from last year. The capital asset increase was the result of the final construction and installation of the sewer system offset by the current year depreciation expense.

Debt

During the year, the Authority's long-term debt decreased by \$418,096. This decrease was due to normal required debt payments. The Authority ended the year with total debt outstanding of \$6,731,904.

Economic Factors

The fiscal year ended March 31, 2006 was the first full year of significant operations. However, not all residences were charged for services until July 2005. Revenues should increase significantly since all residences will be billed for a full year the year ended March 31, 2007.

The Authority is also anticipating the completion of a strategic plan during the year. This strategic plan will include a five year financial projection. As part of this projection, it may be determined that current debt and operational rates may need to be adjusted.

Contacting the Authority Financial Management

This financial report is designed to provide a general overview of the Authority's finances for all those interested in the Authority's finances. If you have any questions about this report or need additional information, contact the Chain of Lakes Area Utilities Authority at P.O. Box 863, Newaygo, MI 49337.

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

June 14, 2006

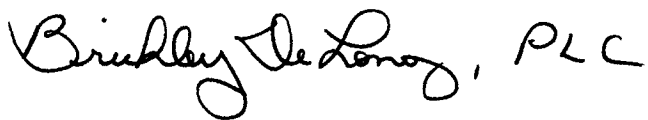
Board of Directors
Chain of Lakes Area Utilities Authority
Newaygo, Michigan

We have audited the accompanying financial statements of the Chain of Lakes Area Utilities Authority as of and for the year ended March 31, 2006, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Chain of Lakes Area Utilities Authority's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Chain of Lakes Area Utilities Authority, as of March 31, 2006, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages i - iv is not a required part of the basic financial statement but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.



Chain of Lakes Area Utilities Authority
STATEMENT OF NET ASSETS
 March 31, 2006

ASSETS

CURRENT ASSETS

Cash and investments	\$ 8,213
Receivables	
Accounts	15,562
Interest	11,503
Litigation receivable	<u>500,000</u>
Total current assets	535,278

NONCURRENT ASSETS

Restricted assets	
Cash and investments	957,853
Special assessments	3,378,207
Capital assets, net	
Nondepreciable	250,000
Depreciable	<u>7,561,258</u>
Total noncurrent assets	<u>12,147,318</u>
Total assets	12,682,596

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

Accounts payable	348,940
Accrued liabilities	112,481
Due to other governmental units	64,002
Bonds and other obligations, due within one year	<u>422,584</u>
Total current liabilities	948,007

NONCURRENT LIABILITIES

Bonds and other obligations, less amounts due within one year	<u>6,309,320</u>
Total liabilities	<u>7,257,327</u>

NET ASSETS

Invested in capital assets, net of related debt	1,098,871
Restricted for debt service	4,215,543
Unrestricted	<u>110,855</u>
Total net assets	<u>\$ 5,425,269</u>

The accompanying notes are an integral part of this statement.

Chain of Lakes Area Utilities Authority
STATEMENT OF ACTIVITIES
For the year ended March 31, 2006

REVENUES	
Charges for services	\$ 221,822
OPERATING EXPENSES	
Administration	
Wages and benefits	10,966
Operations	
Contracted services	235,925
Repairs and maintenance	7,004
Miscellaneous	3,063
Office supplies	553
Insurance	5,041
Professional fees	46,382
Depreciation	154,311
Total operating expenses	<u>463,245</u>
Operating loss	(241,423)
NONOPERATING REVENUES (EXPENSES)	
Investment income	213,724
Interest expense	<u>(262,083)</u>
Total nonoperating revenues (expenses)	<u>(48,359)</u>
Loss before special item	(289,782)
Litigation settlement, net	<u>89,903</u>
Change in net assets	(199,879)
Net assets at April 1, 2005	<u>5,625,148</u>
Net assets at March 31, 2006	<u><u>\$ 5,425,269</u></u>

The accompanying notes are an integral part of this statement.

Chain of Lakes Area Utilities Authority
STATEMENT OF CASH FLOWS
For the year ended March 31, 2006

CASH FLOWS FROM OPERATING ACTIVITIES

Receipts from customers	\$ 204,279
Payments to suppliers	(343,727)
Payments to employees	<u>(6,153)</u>
Net cash used for operating activities	(145,601)

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Special assessments	297,894
Purchases of capital assets	(383,339)
Principal paid on capital debt	(418,096)
Interest paid on capital debt	<u>(266,083)</u>
Net cash used for capital and related financing activities	(769,624)

CASH FLOW FROM INVESTING ACTIVITIES

Investment earnings	<u>214,852</u>
Net decrease in cash and investments	(700,373)

Cash and investments at April 1, 2005	<u>1,666,439</u>
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Cash and investments at March 31, 2006	<u>\$ 966,066</u>
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Reconciliation of cash and investments to the balance sheet	\$ 8,213
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Cash and investments	<u>957,853</u>
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Restricted assets	<u>\$ 966,066</u>
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Reconciliation of operating loss to net cash used for operating activities

Operating loss	\$ (241,423)
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Adjustments to reconcile operating loss to net used for operating activities

Depreciation expense	154,311
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Change in assets and liabilities

Receivables, net	(517,544)
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Accounts payables	424,015
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Accrued liabilities	4,813
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Due to other governmental units	<u>30,227</u>
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Net cash used for operating activities	<u>\$ (145,601)</u>
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The accompanying notes are an integral part of this statement.

Chain of Lakes Area Utilities Authority
NOTES TO FINANCIAL STATEMENTS
March 31, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Chain of Lakes Area Utilities Authority (Authority) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Authority's accounting policies are described below.

Reporting Entity

The Authority is organized pursuant to the provisions of Act 233 PA 1955. The Authority was created by the Townships of Brooks, Evertt and Garfield. The Authority is governed by a six member board appointed by the participating governmental units.

Generally accepted accounting principles require that if the Authority has certain oversight responsibilities over other organizations, those organizations should be included in the Authority's financial statements. Since no organizations met this criteria, none are included in the financial statements.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the financial statements to the extent that those standards do not conflict with or contradict guidance of the Government Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Authority has elected not to follow subsequent private-sector guidance.

Operating revenues and expenses generally result from providing services from ongoing operations. The principal operating revenues are charges to customers for sales and services. The Authority also recognizes as operating revenue the connection fees. These fees intended to recover the cost of connecting new customers to the system. Operating expenses include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed.

Chain of Lakes Area Utilities Authority
NOTES TO FINANCIAL STATEMENTS—CONTINUED
March 31, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Assets, Liabilities and Net Assets or Equity

Deposits and Investments

The Authority's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

The Authority reports its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Under this standard, certain investments are valued at fair value as determined by quoted market prices or by estimated fair values when quoted market prices are not available. The standard also provides that certain investments are valued at cost (or amortized cost) when they are of a short-term duration, the rate of return is fixed, and the Authority intends to hold the investment until maturity.

The Authority has adopted an investment policy in compliance with State of Michigan statutes. Those statutes authorize the Authority to invest in obligations of the United States, certificates of deposit, prime commercial paper, securities guaranteed by United States agencies or instrumentalities, United States government or federal agency obligation repurchase agreements, bankers acceptances, state-approved investment pools and certain mutual funds.

Receivables and Payables

All trade receivables are shown net of allowance for uncollectibles.

Prepaid Items

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

Restricted Assets

Certain proceeds of the bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because they are maintained in separate bank accounts and their use is limited by applicable bond covenants.

Capital Assets

Capital assets, which include property, plant, and equipment, are defined by the Authority as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

Property, plant and equipment is depreciated using the straight-line method over 50 years.

Chain of Lakes Area Utilities Authority
NOTES TO FINANCIAL STATEMENTS—CONTINUED
March 31, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Assets, Liabilities and Net Assets or Equity—Continued

Long-Term Obligations

Long-term debt and other long-term obligations are reported as liabilities in the statement of net assets. Bond premiums and discounts as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures.

NOTE B—DEPOSITS AND INVESTMENTS

As of March 31, 2006, the Authority voluntarily invested \$671,530 in an unrated external pooled investment pool (Pool). The Pool is an external investment pool of "qualified" investments for Michigan municipalities. The Pool is not regulated nor registered with the SEC. The fair value of the Authority's investments is the same as the fair value of the Pool.

Interest rate risk. The Authority does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit risk. State law limits investments in commercial paper and corporate bonds to the two highest classifications issued by nationally recognized statistical rating organizations (NRSROs). The Authority has no investment policy that would further limit its investment choices.

Concentration of credit risk. The Authority does not have a concentration of credit risk policy. Concentration of credit risk is the risk of loss attributed to the magnitude of the Authority investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized.

Custodial credit risk - deposits. In the case of deposits, this is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. As of March 31, 2006, \$166,806 of the Authority's bank balance of \$294,763 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial credit risk - investments. The Authority does not have a custodial credit risk policy for investments. This is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

Foreign currency risk. The Authority is not authorized to invest in investments which have this type of risk.

Chain of Lakes Area Utilities Authority
NOTES TO FINANCIAL STATEMENTS—CONTINUED
March 31, 2006

NOTE B—DEPOSITS AND INVESTMENTS—Continued

Restricted Assets

Restrictions are placed on assets by bond ordinance and Authority Board action. At March 31, 2006, cash and investments were restricted as follows:

Debt service	\$ 938,336
Construction	<u>19,517</u>
	<u><u>\$ 957,853</u></u>

The special assessment receivable is restricted for repayment of long-term debt.

NOTE C—CAPITAL ASSETS

Capital asset activity for the year ended March 31, 2006 was as follows:

	<u>Balance</u> <u>April 1, 2005</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>March 31, 2006</u>
Capital assets, not being depreciated:				
Land	\$ 250,000	\$ -	\$ -	\$ 250,000
Capital assets, being depreciated:				
Plant	7,332,230	383,339	-	7,715,569
Less accumulated depreciation	<u>-</u>	<u>(154,311)</u>	<u>-</u>	<u>(154,311)</u>
Total capital assets, being depreciated, net	<u>7,332,230</u>	<u>229,028</u>	<u>-</u>	<u>7,561,258</u>
Capital assets, net	<u><u>\$ 7,582,230</u></u>	<u><u>\$ 229,028</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 7,811,258</u></u>

NOTE D—LONG-TERM DEBT

Summary of Changes in Long-Term Liabilities

The following is a summary of long-term liabilities activity for the Authority for the year ended March 31, 2006.

	<u>Balance</u> <u>April 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>March 31, 2006</u>	<u>Due within</u> <u>one year</u>
Limited tax obligation bonds	\$ 6,650,000	\$ -	\$ 300,000	\$ 6,350,000	\$ 300,000
Intergovernmental loan	<u>500,000</u>	<u>-</u>	<u>118,096</u>	<u>381,904</u>	<u>122,584</u>
Governmental activity long-term liabilities	<u><u>\$ 7,150,000</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 418,096</u></u>	<u><u>\$ 6,731,904</u></u>	<u><u>\$ 422,584</u></u>

Chain of Lakes Area Utilities Authority
NOTES TO FINANCIAL STATEMENTS—CONTINUED
March 31, 2006

NOTE D—LONG-TERM DEBT—Continued

Summary of Changes in Long-Term Liabilities—Continued

Limited tax obligation bonds

\$6,915,000 Limited Tax Obligation Bonds of 2002	
due in annual installment of \$265,000 to \$400,000	
through May 2022; interest at rates varying from	
2.5% to 4.55%	\$ 6,350,000

Intergovernmental loan

\$500,000 County Board of Public Works Tax	
Revolving Loan of 2004 due in annual installments	
of \$137,096 including interest at 3.8%	381,904
	\$ 6,731,904

The Limited Tax Obligation Bonds due to the County of Newaygo represent an agreement with Newaygo County relating to the construction of sewage treatment facilities. To construct these facilities, the County issued bonds which the Authority is obligated to repay. The Authority has recorded the liability for the County bonds along with a capital asset. The contractual obligation is secured by the full faith and credit of the Authority and is guaranteed by the participating creating townships.

Annual debt service requirements to maturity for debt outstanding as of March 31, 2006 follows:

Year ending <u>March 31,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 422,584	\$ 254,175
2998	427,242	241,267
2009	457,078	227,057
2010	350,000	211,475
2011	350,000	199,663
2012-2016	1,925,000	786,619
2017-2021	2,000,000	393,100
2022-2023	800,000	36,200
	\$ 6,731,904	\$ 2,349,556

Chain of Lakes Area Utilities Authority
NOTES TO FINANCIAL STATEMENTS—CONTINUED
March 31, 2006

NOTE E—OTHER INFORMATION

Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees and natural disasters. The Authority manages its liability and property risk by purchasing commercial insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Litigation Settlement

During the year ended March 31, 2006, the Authority settled a lawsuit against the company responsible for construction of the wastewater facility and related infrastructure. As part of this litigation, the Authority was awarded \$500,000 as a gross settlement of the litigation. The Authority incurred \$410,097 in related legal and other expenses related to the case. These amounts have been recorded as a special item in the financial statements.

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

June 14, 2006

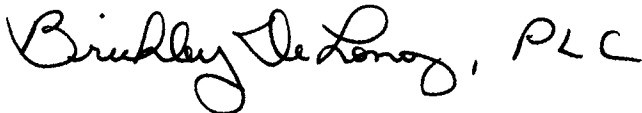
Board of Directors
Chain of Lakes Area Utilities Authority
Newaygo, Michigan

In planning and performing our audit of the financial statements of the Chain of Lakes Area Utilities Authority for the year ended March 31, 2006, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted certain matter involving the internal control and its operation that we consider to be a reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Chain of Lakes Area Utilities Authority's ability to initiate, record, process and report financial data consistent with the assertions of management in the financial statements. We have attached a summary of the reportable conditions.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we do not believe any of the attached reportable conditions are material weaknesses.

This report is intended solely for the information of the Board of Directors, management, and others within the administration and is not intended to be and should not be used by anyone other than these specified parties.



REPORTABLE CONDITIONS

Recommendation 1: The internal control procedures should be further segregated.

Small organizations with limited resources and personnel inherently have difficulty in establishing and maintaining an accounting system with strong internal accounting controls including significant segregation of duties.

The Authority should seek opportunities to further segregate duties and strengthen internal controls. Often, the most effective approach is the assignment of a Board member to open and scan monthly bank statements along with other procedures deemed necessary.

Recommendation 2: The accounting procedures surrounding the tracking and recording of special assessments should be improved.

During our testing, we noted that the Authority has various spreadsheets prepared by the participating townships to track the balance of special assessments. However, the ending balance on one spreadsheet for one year did not match the beginning balance of the following year. This appears to be the result of additional collections being received and recorded on one spreadsheet without updating the subsequent year spreadsheets. In addition, the special assessments were reported as revenue when cash was received. The principal portion of the special assessment received should be recorded as a reduction of special assessments receivable.

The Authority should utilize three spreadsheets to track the special assessments. One spreadsheet should be maintained by each participating township. These spreadsheets should automatically update to reflect any changes made to it. The special assessment collections should be allocated between principal and interest at the time of collection. The interest portion should be recorded as interest income and the principal portion should be recorded as a decrease to special assessments receivable.

Recommendation 3: The Authority should complete a financial projection.

During our testing, we noted that the construction of the sewer system required the borrowing of \$500,000 in additional unexpected funds. The special assessment was established to repay the debt based upon the original bond issue. In addition, the Authority appears to have incurred additional unanticipated costs such as legal fees and a delay in residence hooking up to the system which delayed anticipated revenues.

Based upon the items noted above, the Authority should develop a financial projection of at least five years if not more. The Authority should schedule out all debt and maintenance requirements and match them against projected revenues and special assessment collection.

REPORTABLE CONDITIONS—CONTINUED

Recommendation 4: The Authority should improve its billing and cash receipts system.

During our testing, we noted revenues were not recorded until cash was received. The Authority hired an outside third party to prepare the billing and complete the cash collections process, but quarterly billings are not recorded until cash is collected. In addition, there is limited monitoring of this outside service.

The Authority should establish procedures to ensure that the billings are done correctly, receivables are recorded when billed and all accounts receivable balances are reconciled to supporting details on a monthly basis.

Recommendation 5: The accounts payable detailed trial balance should be reconciled with the general ledger on a monthly basis.

During our testing, we noted that the March 31, 2006 accounts payable detailed listing did not reconcile to the general ledger and that such a reconciliation had not been performed for several months. Subsequently, adjusting journal entries were required to reconcile the two amounts.

The regular reconciliation of accounts payable general ledger balances and detailed trial balances would provide further assurance that accounts payable and the related expense balances are properly stated in interim monthly financial statements.